Good news on household debt could be bad news for economic growth

By Scott Barlow
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Indebted Canadians are finally addressing their balance sheets and two major economists have drastically different views on the dangers the trend presents to the domestic economy.

Reports released last week provided unequivocal evidence that domestic credit growth is slowing rapidly. Statscan's report on National Balance Sheet Accounts revealed that domestic household credit growth, at a 2-per-cent inflation-adjusted rate, was the lowest result in two decades.

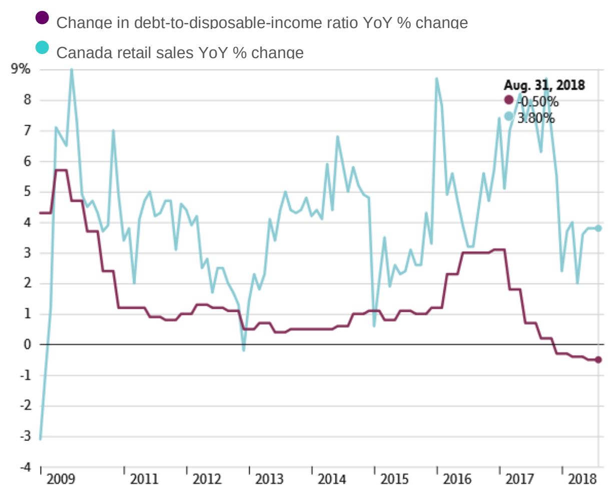
Bank of Montreal economist Douglas Porter wrote that while the housing market explains much of the trend in 2018, slowing consumer spending is also playing a role in reducing borrowing. "Household consumption doesn't get the headlines that housing receives, but it's the much bigger driver of overall activity, and it has taken a notable step back this year," he said.

Mr. Porter points out that auto sales are poised for their first annual decline since 2009 and year-over-year overall spending is on pace to slow from 2017's 6-per-cent pace to a far weaker 1 per cent in 2018. The title of Mr. Porter's report, One Cylinder Down in Canada, highlights his concern that slower credit and consumer spending will result in weaker overall economic growth.

CIBC economist Benjamin Tal posted a far more optimistic perspective on the Statscan data. Mr. Tal accepts that "the mortgage market is a shadow of its former self" and overall credit growth is the slowest it's been in any non-recession period since the early 1990s.

The economist notes, however, that there are few signs of financial distress accompanying the debt slowdown. "Delinquency rates in all products are at, or close to, their record lows, the average credit score continues to rise, and principal payments currently account for no less than 50 per cent of total debt payments – a record high," he writes. "With every day that passes, the risk profile of the country's mortgage portfolio is actually improving."

Healthy trend: Canadian debt-to-income ratio falls as retail sales remain solid



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Mr. Tal's view opens the door to a relatively pain-free economic scenario in which current interest rates – primarily mortgage rates – are low enough to allow Canadians to pay down debt quickly, but high enough to encourage us not to take on more debt. Regulatory measures to cool the housing mania are clearly another major factor behind the slower pace of indebtedness, motivating consumers to pay off existing liabilities instead of borrowing.

Mr. Porter's main point, however, is an important one. The debt deleveraging process will exact a price on overall economic growth in the form of lower retail sales, and unfortunately consumption is the most important driver of growth for a modern, services-oriented economy such as Canada's.

As long as year-over-year retail sales data don't collapse into deeply negative territory and unemployment rates don't start to climb (I am personally concerned about real estate-related job losses as the housing market slows), the combination of slower credit growth, a mild reduction in consumption and rapid repayment of existing debt, is a long-term positive for the Canadian economy.